

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7270

Joint Petition of Verizon New England Inc.,)
d/b/a Verizon Vermont, certain affiliates)
thereof, and FairPoint Communications, Inc. for)
approval of an asset transfer, acquisition of)
control by merger and associated transactions)

Order entered: 3/25/2009

**ORDER RE: MOTION FOR LIMITED MODIFICATION
TO FINAL ORDER AND CERTIFICATES OF PUBLIC GOOD**

INTRODUCTION

On February 27, 2009, Northern New England Telephone Operations LLC and Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications (collectively, "FairPoint") filed a motion for limited modification of Condition 35 of the Vermont Public Service Board's ("Board") February 15, 2008, Order ("Order") approving FairPoint's acquisition of Verizon New England Inc., d/b/a Verizon Vermont ("Verizon"). FairPoint also requested modification to Paragraph 30 of Attachment 1 to the Certificates of Public Good ("CPG") that were issued contemporaneously (Paragraph 30 of Attachment 1 is identical to Condition 35 of the Order). Condition 35 requires FairPoint to begin paying down its existing debt by the higher of \$45,000,000 or 90% of its Free Cash Flow annually, commencing with the end of the first quarter of 2009. FairPoint seeks to delay the first payment until the end of the second quarter of 2009.

The Department of Public Service ("Department") supports FairPoint's proposed change. No other party commented.

We find FairPoint's request to be reasonable and approve it. As we explain below, the delay in the first payment is consistent with FairPoint's debt obligations, which require that the principal payments commence in the second quarter. At the same time, the delay will allow FairPoint to retain additional cash, enhancing its liquidity and ability to respond to capital and other demands.

BACKGROUND

Condition 35 of the Order approving FairPoint's acquisition of Verizon's Vermont properties specifies that:

Beginning in the first quarter of 2009, FairPoint shall pay the higher of \$45,000,000 annually, or 90% of annual Free Cash Flow, to be applied equally in each fiscal quarter, towards the permanent reduction of the principal amount of the Term Loan(s). Free Cash Flow is defined as the cash flow remaining after all operating expenses, interest payments, tax payments, capital expenditures, dividends and other routine cash expenditures have occurred. (For the first year of operations, this calculation would include all adjustments permitted by the current and the new loan documents.)

This provision was based upon an agreement between FairPoint and the Department. It was also the same as a provision to which FairPoint had agreed to in the State of Maine.

In its Motion, FairPoint represents that the repayment schedule specified in the Credit Agreement (which was dated March 31, 2008) provides that principal payments would commence on June 30, 2009. As a result, FairPoint maintains that the March 31, 2009, payment required by Condition 35 would be an early prepayment not required by the Credit Agreement. FairPoint also asserts that due to the recent cutover of systems from Verizon to FairPoint, certain aspects of its operations are behind normal schedules, including the billing. This has resulted in extended cash collection cycles which "will have a short-term negative impact on liquidity for the next several months."¹ Although FairPoint contends that it still has sufficient cash flow to meet its obligations, it "believes this is not the time to be making voluntary prepayments under its Credit Agreement," particularly since it believes that the after-effects of cutover may increase customer turnover.

FairPoint also argues that instead of making the prepayment, it may have the ability to buy back certain senior notes (due 2018) which have an interest rate of 13 1/8% and are now trading at a significant discount. For these reasons, FairPoint asks that we modify Condition 35 to permit FairPoint to make the first quarterly payment of principal on June 30, 2009, rather than

1. Motion at 2.

March 31, 2009. FairPoint states that this should not have a material effect on its long-term financial results or the outcome intended by the Order, because it estimates that the total amount paid on its indebtedness during calendar 2009 will exceed \$45,000,000. Moreover, FairPoint states that the modification would assist it in managing its cash-flow needs which have been adversely affected by the cutover, the extended operation under the Transition Services Agreement ("TSA") with Verizon, the economy, and the loss of availability of \$30,000,000 of revolving credit capacity due to the bankruptcy of Lehman Brothers, Inc.

The Department supports the proposed modification. The Department states that its position relies upon FairPoint's assertion that it will have sufficient liquidity to meet all of its obligations. The Department recommends that we adopt the following language in place of the first sentence of Condition 35:

Beginning no later than the second quarter of 2009, FairPoint shall pay the higher of \$45,000,000 annually (\$11,250,000 quarterly) or 90% of annual Free Cash Flow, to be applied equally in each fiscal quarter, towards the permanent reduction of the principal amount of outstanding debt. . . .

DISCUSSION

We find FairPoint's proposal to be reasonable and approve it. Under FairPoint's proposal, the obligation to pay down the outstanding debt at a rate of at least \$45,000,000 per year remains. The modification simply allows FairPoint to delay the initial payments. As a result, the principal payments under the modified condition will be consistent with the credit agreement. Delay in the initial principal payments will also enhance FairPoint's liquidity. As the Company stated in its motion, a number of recent events have placed increased stress upon FairPoint's financial position. These include payments under the TSA that continued longer than anticipated, larger line losses than projected, and the possible loss of customers due to the problems incurred following the cutover of systems. The delay in principal payments will help offset the effects of these events.

Although we allow FairPoint to delay paying down its debt, we remain concerned about FairPoint's overall financial status. Our Orders of December 22, 2007, and February 15, 2008, concerning FairPoint's acquisition laid out these concerns. Condition 35 was adopted (based

upon a Memorandum of Understanding between FairPoint and the Department, which incorporated an identical condition previously agreed to in Maine) as part of our efforts to reduce the financial pressures on FairPoint arising from the heavily leveraged transaction. Reduction in debt over time, as required by Condition 35, should help address these concerns.

We modify Condition 35 of the Order and Paragraph 30 of Attachment 1 of the CPG's to read as follows:

Beginning no later than the second quarter of 2009, FairPoint shall pay the higher of \$45,000,000 annually, or 90% of annual Free Cash Flow, to be applied equally in each fiscal quarter, towards the permanent reduction of the principal amount of the Term Loan(s). Free Cash Flow is defined as the cash flow remaining after all operating expenses, interest payments, tax payments, capital expenditures, dividends and other routine cash expenditures have occurred. (For the first year of operations, this calculation would include all adjustments permitted by the current and the new loan documents.).

So ORDERED.

Dated at Montpelier, Vermont, this 25th day of March, 2009.

<u>s/James Volz</u>)	
)	
)	PUBLIC SERVICE
<u>s/David C. Coen</u>)	
)	BOARD
)	
)	OF VERMONT
<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: March 25, 2009

ATTEST: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.